

Letter of Findings Number: 02-20140078
Corporate Income Tax
For Tax Years 2008, 2009, and 2010

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is superseded by the publication of another document in the Indiana Register.

ISSUES

I. Adjusted Gross Income Tax - Liability.

Authority: IC § 6-3-2-1; IC § 6-3-2-2; IC § 6-8.1-5-1; Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Phoenix Coal Co. v. C.I.R., 231 F.2d 420 (2d Cir. 1956); [45 IAC 3.1-1-55](#).

Taxpayer protests the imposition of additional income tax.

II. Tax Administration - Negligence Penalty and Interest.

Authority: IC § 6-8.1-5-1; IC § 6-8.1-10-2.1; Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); [45 IAC 15-11-2](#).

Taxpayer protests the imposition of ten percent negligence penalties.

STATEMENT OF FACTS

Taxpayer files a consolidated return with multiple members. For the years at issue, two of Taxpayer's members (hereafter referred to collectively as "Taxpayer") had locations in Northeastern and Southeastern Indiana. Taxpayer provides ambulance services. Taxpayer also provides physician services for hospitals and clinics and management services for inpatient radiology divisions. Taxpayer had contracts with hospitals located in Indiana. The Indiana Department of Revenue ("Department") conducted an audit for the 2008, 2009, and 2010 tax years. Taxpayer reported Indiana receipts using a "cost of performance methodology." The Department disagreed with this methodology and issued proposed assessments of additional income tax, penalties, and interest. Taxpayer protests the additional income tax and penalties. An administrative hearing was held, and this Letter of Findings results. Additional facts will be supplied as needed.

I. Adjusted Gross Income Tax - Liability.

DISCUSSION

The Department disagreed with Taxpayer's use of a "cost of performance methodology" to calculate Indiana receipts. The Department adjusted Taxpayer's income tax returns for the tax years 2008, 2009, and 2010, including Taxpayer's net operating losses ("NOLs") for particular years, and issued proposed assessments of additional income tax. Taxpayer protests the proposed assessments of additional income tax. In doing so, Taxpayer protests the Department's rejection of its "cost of performance methodology." It also protests the Department's adjustment of a closed year in order to calculate Taxpayer's NOLs for the tax years at issue. Finally, Taxpayer points out several items in the audit report that it calls "computational errors" which, if adjusted, would change the proposed assessment.

All tax assessments are prima facie evidence that the Department's claim for the tax is valid, and the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012). The issue is whether Taxpayer met its burden to prove the proposed assessment is incorrect.

A. Taxpayer's Cost of Performance Methodology

Indiana imposes an adjusted gross income tax on "income derived from sources in Indiana of every corporation." IC § 6-3-2-1(b). "Income derived from sources in Indiana" is defined as "income from doing business in this state."

IC § 6-3-2-2(a)(2). If a corporation's income "is derived from sources within the state of Indiana and from sources without the state of Indiana," the income apportioned to Indiana for tax purposes is calculated by multiplying the corporation's total income by the apportionment factor. IC § 6-3-2-2(b). For the years at issue, the apportionment factor formula included a "sales factor." IC § 6-3-2-2(b). "The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the taxable year, and the denominator of which is the total sales of the taxpayer everywhere during the taxable year." IC § 6-3-2-2(e). Sales, giving rise to a corporation's income, are considered to be in Indiana if "the income-producing activity is performed in this state." IC § 6-3-2-2(f)(1). Therefore, the receipts from sales are Indiana receipts to the extent that "income-producing activity is performed in this state" and are included in the sales factor numerator. IC § 6-3-2-2(f)(1). "Income-producing activity" is defined as "the act or acts directly engaged in by the taxpayer for the ultimate purpose of obtaining gains or profit." [45 IAC 3.1-1-55](#). Income-producing activity is "deemed performed at . . . the place where personal services are rendered." [45 IAC 3.1-1-55](#). Specifically, [45 IAC 3.1-1-55\(d\)](#) provides:

Gross receipts for the performance of personal services are attributable to this state to the extent such services are performed in this state. If the services are performed partly within and without this state, such receipts shall be attributed to this state based upon the ratio which the time spent in performing such services in this state bears to the total time spent in performing such services everywhere. Time spent in performing services includes the amount of time expended in the performance of a contract or other obligation which gives rise to such gross receipts. (Emphasis added).

Where the sale is comprised of personal services performed within and without Indiana, [45 IAC 3.1-1-55](#) requires the taxpayer to calculate a portion of the receipts to be attributed to Indiana based on the amount of time spent performing personal services in Indiana. This section does not require that the entire receipt from the sale be attributed to Indiana, as required by IC § 6-3-2-2(f)(2), but only that portion of the receipt associated with the personal services rendered in Indiana. [45 IAC 3.1-1-55](#). Therefore, if the income-producing activity (i.e. acts directly engaged in by a corporation for the ultimate purpose of obtaining gains) are personal services which are rendered in Indiana, then the income-producing activity is deemed performed in Indiana for purposes of IC § 6-3-2-2(f)(1), and the receipts from the transactions related to the income-producing activity are included in the sales factor numerator pursuant to IC § 6-3-2-2(b) and (e). Only if income-producing activity is performed within and without Indiana will a taxpayer's costs of performance be considered to determine whether the receipts of such sale should be included in the sales factor numerator. IC § 6-3-2-2(f)(2); [45 IAC 3.1-1-55](#).

Taxpayer is a corporation subject to an adjusted gross income tax on the income it derives from sources in Indiana. IC § 6-3-2-1(b). During the audit years, Taxpayer derived income from sources in Indiana, specifically from its provision of "all types of ambulance services, air and ground," as well as physician services and inpatient radiology management services provided at Indiana hospitals and clinics.

Taxpayer concedes the above, and agrees that its income-producing activity (i.e. act or acts directly engaged in by Taxpayer for the ultimate purpose of obtaining gains) is the driving of ambulances, provision of emergency medical services during an ambulance ride, provision of physician services at hospitals, and provision of management services at hospitals, among other services and sales. However, it argues that the two members with Indiana locations also operate and perform these services in other states. Taxpayer's "cost of performance methodology" appears to combine these members' sales in Indiana with their sales in the other states in which they operate. With all of these sales combined, Taxpayer argues that the greater proportion of the income-producing activity of these members (i.e. driving of ambulance, provision of physician services, etc.) occurs outside Indiana.

In fact, for one of the audit years, Taxpayer points out that use of its "cost of performance methodology" actually resulted in all of the receipts from sales made by one member being included in the Indiana sales factor numerator because, according to its argument, the greater proportion of that member's income-producing activity occurred in Indiana. Taxpayer provided additional documentation showing the actual Indiana sales for this member and this particular year.

However, for the applicable tax years, Taxpayer's members had locations in Northeastern and Southeastern Indiana, and had contracts with hospitals in Indiana to perform physician and management services. The Taxpayer concedes that the income-producing activity is the driving of ambulances, provision of emergency medical services during an ambulance ride, provision of physician services at hospitals, and provision of management services at hospitals, among other services and sales. The audit report states:

The personnel and the equipment used to perform these services are located in Indiana[,] and the service is performed within Indiana. The ambulances and drivers used to perform the ambulance services within

Indiana are located in Indiana. The physicians operating in Indiana clinics, hospitals etc. are physically located in Indiana.

The sales of these services are deemed performed at the place where the personal services are rendered, and in this case, they are deemed performed in Indiana. [45 IAC 3.1-1-55](#). Taxpayer has not demonstrated otherwise. Because the income-producing activity (i.e. the driving of ambulances, performance of emergency medical services, provision of physician and management services at hospital locations in Indiana, etc.) is performed in Indiana, the resulting receipts are included in the numerator of the sales factor and are income derived from sources in Indiana. IC § 6-3-2-2(f)(1).

Additionally, even if the Department allowed Taxpayer's "cost of performance methodology," it would not be able to accurately identify Taxpayer's costs of performance as Taxpayer has not provided a study, or other sufficient documentation, which appropriately identifies its costs of performance, their location, or their value. The audit report appropriately disallowed Taxpayer's "cost of performance" method of allocating its sales revenues and properly apportioned Taxpayer's Indiana income.

Sales and services provided which were based out of Taxpayer's Southeastern location may give rise to circumstances where income-producing activity is performed both within Indiana and within Kentucky. For example, this might include the provision of medical services during an ambulance ride from a Kentucky home to an Indiana hospital. [45 IAC 3.1-1-55](#) (stating "If the services are performed partly within and without this state, such receipts shall be attributed to this state based upon the ratio which the time spent in performing such services in this state bears to the total time spent in performing such services everywhere."). However, Taxpayer has not argued or demonstrated that this is the case.

As noted, Taxpayer's "cost of performance methodology" resulted in its improper inclusion of all of its Kentucky receipts being included as 2010 Indiana income. The Department will adjust the in-state sales amount used to calculate Taxpayer's 2010 Indiana income subject to supplemental audit of the documentation Taxpayer provided which shows its actual in-state sales for tax year 2010.

Taxpayer's protest of the Department's disallowance of its "cost of performance methodology" is respectfully denied. The Department will recalculate the proposed assessments to reflect the correct Indiana income for tax year 2010.

B. Department's Adjustment of a Closed Year

Taxpayer protests the adjustment of Taxpayer's Indiana receipts for the tax year 2006. Taxpayer argues that this is a closed year which precludes the adjustments made by the Department.

During its audit, the Department recognized that Taxpayer sustained NOLs in the periods prior to December 31, 2006, as well as in 2007 and 2008. During the tax years at issue, Taxpayer used a "cost of performance methodology" to calculate its Indiana receipts and income. The Department rejected this methodology and adjusted the apportionment percentages used. Adjustment of the apportionment percentages results in changes to the income and losses reported by Taxpayer. The Department's adjustment of the NOL reported in tax year 2006 was necessary to accurately determine the proper amount of NOL carryforwards available for the succeeding years. The Department did not adjust the NOL for tax year 2006 in order to reassess tax year 2006, but rather to ensure an accurate calculation of additional income tax due in years 2009 and 2010. Additionally, the Department follows the federal rules concerning the application of NOLs, and pursuant to *Phoenix Coal Co. v. C.I.R.*, 231 F.2d 420 (2d Cir. 1956). Taxpayer's protest of the Department's adjustment of a closed year is respectfully denied.

C. Audit Report's Computational Errors

Taxpayer points out several of what it calls "computational errors" in the final audit report. Each will be addressed below:

1. In-State Sales Amounts

The audit report used a placeholder amount of \$19,000,000 for Taxpayer's in-state sales for tax years 2008 and 2009. During the protest process, Taxpayer provided documentation of its actual in-state sales for tax years 2006 through 2009.

As previously noted, Taxpayer explains that the in-state sales amount used for 2010 should be adjusted since the amount listed in the audit report included Kentucky sales. Taxpayer included these Kentucky sales in the 2010 amount based on its "cost of performance methodology" of calculating Indiana receipts. The Department has disallowed Taxpayer's use of its "cost of performance methodology." Taxpayer has provided documentation to show its actual Indiana in-state sales for tax year 2010.

Taxpayer's protest of the audit report's use of projected in-state sales numbers and an in-state sales number including Kentucky sales is sustained subject to a supplemental audit of the documentation provided by Taxpayer.

2. FYE 12/31/2007 Apportionment Percentage

Taxpayer states that the 2007 apportionment percentage was calculated incorrectly by the Department. It has provided documentation showing the correct calculation. Taxpayer also states that if the projected in-state sales amounts are replaced with the actual in-state sales amounts (as provided during the protest process), this percentage will necessarily change. Therefore, Taxpayer's protest of the FYE 12/31/2007 apportionment percentage calculation is sustained subject to a supplemental audit of the documentation provided during the protest process.

3. Unused NOL Carryforward from Periods Ending 8/31/1999 and 8/31/2000

Taxpayer states that the amounts listed on page 10 of the audit representing the unused NOL carryforward from the periods ending 8/31/1999 and 8/31/2000 are incorrect. Taxpayer has provided documentation to support its assertion that these amounts are incorrect. Taxpayer's protest is sustained subject to a supplemental audit of the documentation provided during the protest process.

FINDING

Taxpayer's protests on the issues of its use of a "cost of performance methodology" and the Department's adjustment of a closed year are respectfully denied. Taxpayer's protests of what it identified as "computational errors" in the audit report are sustained subject to a supplemental audit of the documentation provided during the protest process.

II. Tax Administration - Negligence Penalty.

DISCUSSION

The Department issued proposed assessments for base income tax, penalties, and interest for the tax years 2009 and 2010. Taxpayer protested the imposition of the penalties. Again, all tax assessments are prima facie evidence that the Department's claim for the tax is valid, and the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012). The issue before the Department is whether Taxpayer met its burden to prove the proposed assessments are incorrect.

A taxpayer who receives a proposed assessment after an audit "is subject to a penalty." IC § 6-8.1-10-2.1(a). The Department shall waive the penalty if the taxpayer demonstrates that the failure to pay the outstanding taxes "was due to reasonable cause and not due to willful neglect." IC § 6-8.1-10-2.1(d); see also [45 IAC 15-11-2](#). The taxpayer may demonstrate reasonable cause by showing affirmatively that it used "ordinary business care and prudence" in not paying the outstanding taxes. However, the taxpayer's ignorance of Indiana's tax laws does not constitute reasonable cause. Whether a taxpayer demonstrates reasonable cause for penalty purposes is a fact-sensitive question and determined on a case-by-case basis. [45 IAC 15-11-2\(b\)](#) and (c).

In this case, Taxpayer has affirmatively demonstrated that it had a reasonable cause for its failure to pay the proper amount of income tax in 2009 and 2010. Consequently the penalties are waived, and Taxpayer's protest is sustained.

FINDING

Taxpayer's protest is sustained.

SUMMARY

Taxpayer's protests of Issue I regarding its use of a "cost of performance methodology" and the Department's adjustment of a closed year are respectfully denied. Taxpayer's protests of Issue I regarding what it called "computational errors" in the audit report are sustained subject to a supplemental audit of the documentation provided during the protest process.

Taxpayer's protest is sustained on Issue II regarding imposition of negligence penalties.

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